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C O N F I D E N T I A L SECTION 01 OF 02 HONG KONG 000649

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STATE FOR EAP/CM; STATE PASS USTR JEFF LEE AND LEWIS
KARESH; PASS CPSC RICHARD O'BRIEN; STATE PASS LABOR FOR
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SUBJECT: HONG KONG TOY MANUFACTURERS STRUGGLE WITH U.S.
PRODUCT SAFETY DEMANDS, DELAYED CUSTOMER ORDERS

REF: A. 08 HONG KONG 2211

[1B.](#) 08 HONG KONG 1989

[1C.](#) 08 GUANGZHOU 696

[1D.](#) 08 GUANGZHOU 618

[1E.](#) 08 GUANGZHOU 715

[1F.](#) GUANGZHOU 163

Classified By: Consul General Joe Donovan for reasons 1.4 (b) and (d).

[11.](#) (C) Summary: Leaders of Hong Kong-based toy manufacturers in Guangdong Province say their orders from global retailers have declined 30 percent from last year, leading to additional closures of small- and medium-sized manufacturing facilities. The Chairman of the Hong Kong Toys Council (HKTC) said almost two-thirds of Guangdong's toy manufacturers and exporters have ceased operations since 2007. Our toy manufacturing interlocutors say provincial and local government officials in Guangdong have begun assisting them to manage contentious labor issues, including helping one manufacturer violate China's labor regulations on overtime limits. The U.S. Consumer Product Safety Improvement Act (CPSIA) of 2008 remains toy makers' most significant operating challenge, and they criticized new regulations related to the CPSIA as precipitous and opaque. HKTC's Chairman asserted that widespread corruption had infiltrated the factory audit process of a new Toy Safety Certification Program. (Note: Consulate General Guangzhou has reviewed this cable.) End summary.

[12.](#) (C) Comment: Hong Kong-based toy manufacturers dominate the toy production scene in Guangdong. They are disproportionately affected by the CPSIA's far-reaching new requirements, as the CPSIA emphasizes ensuring the safety of children's products. Their ongoing complaints about the CPSIA and the CPSC reflect nervousness about actual and potential product safety lawsuits filed against them in the United States, as well as uncertainty about their ultimate production and supply chain management costs related to CPSIA compliance (Ref C). ConGens Hong Kong and Guangzhou believe the economic downturn and CPSIA compliance costs will continue to eliminate many toy manufacturers in Guangdong, especially among weaker small and medium-sized firms. This consolidation process will leave the largest and most sophisticated Hong Kong-based firms with greater market share and bargaining power versus buyers, when economic conditions finally improve (Ref D). End comment.

Toy Orders Down 30 Percent in 2009

[13.](#) (C) The Hong Kong Toys Council (HKTC) and the Toy

Manufacturers' Association of Hong Kong (TMAHK) represent the interests of Hong Kong-based toy manufacturers with operations in China's Guangdong Province. HKTC Chairman Lawrence Chan owns toy manufacturing facilities in Shenzhen and Dongguan that collectively employ over 10,000 workers. He told us on April 1 that global toy orders from Guangdong manufacturing facilities are down approximately 30 percent in 2009 year-over-year. Chan said buyers in the United States and Europe will continue to delay orders for the Christmas season "until July or August," in order to better gauge economic developments and more accurately estimate retail sales for the fourth quarter of 2009.

¶ 14. (C) According to Chan, the number of toy manufacturing companies in Guangdong declined from 8,000 in 2007 to 3,000 today, with small- and medium-sized (SME) enterprises hit hardest (Ref E). He expects the consolidation process to continue throughout 2009, given the distressed global economic climate and the CPSIA's compliance requirements. TMAHK Executive Vice President C.K. Yeung, who also owns toy manufacturing facilities in Guangdong, told us toy orders will ramp up as 2009 progresses, but said his U.S. toy retailer customers project a 10-15 percent decline in 2009 retail sales.

Haves and Have-Nots: Overtime and Unemployment

¶ 15. (C) Bernie Ting, general manager of a Hong Kong-based toy manufacturer that employs 8,000 individuals in Guangdong, told us on April 1 that his workers who returned from their

HONG KONG 00000649 002 OF 002

rural homes after Chinese New Year in February 2009 demand overtime hours in excess of the 36 hours per month allowed under China's Labor Contract Law (LCL) of 2008 (Ref F). He said, "They come to work hard and make money. They get very upset if I try to cut their overtime hours, and this prevents me from hiring more workers." Yeung and Chan agreed with Ting's assessment.

¶ 16. (C) While most workers prefer significant overtime hours, Chan said some of his workers recently initiated a lawsuit against him and his company for exceeding the LCL's overtime limits. He said, "Some ambulance-chasing lawyers riled up a few of them. I'm giving my workers exactly what they want - 72 hours or more of overtime per month." Guangdong's provincial and local government officials have begun working with manufacturers to ensure that labor-related lawsuits don't go forward, according to Chan. He said, "I complained to the local government about the lawsuit. They told me it would go away, and it did."

Continued Complaints About CPSIA

¶ 17. (C) Chan, Yeung and Ting said CPSIA requirements represent their greatest operating challenge. They reiterated earlier complaints about the rapid implementation of the law's product testing requirements and sharp restrictions on lead and phthalates (Refs A and B). They criticized the February 5 ruling by the U.S. District Court for the Southern District of New York reversing a U.S. Consumer Products Safety Commission (CPSC) advisory opinion that had allowed the sale of children's products containing certain phthalates (compounds used in plastics manufacturing), as long as the children's products were manufactured before February 10, 2009. The court ruling forced U.S. retailers to quickly pull from their shelves and destroy large quantities of phthalate-containing children's products that would have otherwise been sold with the CPSC's blessing.

¶ 18. (C) Yeung said the State of California recently sued Toys R Us and Yeung's toy manufacturing company, because Toys R Us retained toys on its shelves after February 10 that were banned by the federal court's ruling. Yeung complained that

inclusion of his company in the lawsuit was unfair, as the toys in question had fully complied with relevant standards when manufactured (in 2007) and shipped. He asserted that Hong Kong-based toy manufacturers require more time to comply with "the dizzying number" of new requirements under the CPSIA. Yeung described the February 5 ruling as "symptomatic of the kinds of uncertainties we face," and said the CPSC "must be clearer about their requirements and give us more lead time to comply."

Corruption In New Toy Certification Process?

¶ 9. (C) The U.S. Toy Industry Association (TIA) and the American National Standards Institute (ANSI) plan to roll out their Toy Safety Certification Program (TSCP) in 2009. The TSCP process will certify toys as compliant with all U.S. product safety laws and regulations, including the CPSIA. TSCP-approved toys and/or their packaging will bear a distinctive toy safety mark visible to retail consumers. As part of the TSCP process, ANSI-accredited bodies (i.e., independent audit firms - unrelated to ANSI or TIA - that are confirmed by a member of the International Accreditation Forum to meet ISO 17021 requirements for assessment bodies) have begun to audit toy factories in Guangdong. Chan described the TSCP's factory audit process as "rife with corruption." He said, "If a factory fails the audit, it can go under, so there's tremendous incentive to bribe the individual or company doing the audit. We frequently hear about such payments. We don't want potentially unsafe products entering the United States, because that would hurt all of us." To control this problem, Chan suggested ANSI should use its own staff to audit the performance of its accredited factory auditors in Guangdong.

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